Woman C.P.A.

Volume 29 | Issue 1 Article 8

12-1966

Woman CPA Volume 29, Number 1, December, 1966

American Woman's Society of Certified Public Accountants

American Society of Women Accountants

December 1966

the WOMAN CPA

In this issue

OFFICIAL PUBLICATION

AMERICAN WOMAN'S SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

AMERICAN SOCIETY OF WOMEN ACCOUNTANTS

THE WOMAN CPA

Volume 29 December 1966 Number 1

Trends of Special Interests To the Accountant in Financial Reports

Katherine M. West, CPA

Today, more than ever before, the informational demands upon accounting are steadily increasing. Accountants, at one time referred to primarily as financial historians, are now involved not only in the preparation of financial statements for fiscal periods, which represent chapters in the financial history of the business enterprise, but also in the presentation of statements, such as budgets, that provide for the estimated results of future transactions.

Though there is a marked increase in the scope and quantity of business information made available to outside parties, more information is being sought. Currently, with the growing emphasis on public relations programs, there are those who note that the contents of the financial statements are not keeping pace with the attractive covers and numerous graphs contained in the reports published. The accounting profession with its third-party responsibility is concerned with the ever-present problem of how much information should be furnished to third parties without harming the best interests of the company.

Accounting information must be useful to a wide range of interested parties acting in various capacities both within and outside of the particular business entity. The external users are a heterogeneous group consisting in the main of present and potential investors, employees, stock exchanges, customers, governmental units, creditors, security analysts, trade associations, credit rating bureaus, officers of trade unions, regulatory bodies, economists, the press, etc. Are financial statements considered adequate accounting information for so diverse a group with such widely varying interests? Certainly some users are interested only in specific information, while others want additional relevant data, some of which may be of a forecast nature and not within the scope of verifiability required for externally reported accounting information. Though the basic problem, communication, is not unique and exists in other professions, the demand for a solution is more pronounced.

The need for publicly-owned corporations to raise large aggregates of capital and the sizable increment in the number of shareholders are factors contributing to the wider distribution of financial reports. To be useful, these reports, which serve as a means of communication between the corporation and the stockholders, should be understood to the extent required by each user. Such a requirement is desirable but not easily fulfilled. Often the statements are used by parties with opposing interests, for example, buyers and sellers. The stockholder who is unschooled in accounting may not understand the specialized meanings of some of the words and may not be competent to decide what information is needed. On the other hand, the user at a high level of stockholder sophistication understands to some degree why it is difficult to express complex corporate transactions in simple terms. Even with the increased information contained in financial reports, many of the shareholders, often transient investors, need professional investment advice.

The investment analysts generally want more information than the financial statements contain. They are interested in detailed sales breakdowns, profit breakdowns, operating information of individual entities in a consolidation, statistical reviews, cash-flow statements, and supplementary net-realizable-value statements—important, often confidential information requiring management's approval for distribution. Bank loan officers are inclined to deemphasize financial statements in favor of cash budgets and pro forma statements of future condition.

Even though they agree that it is difficult for the financial statements to satisfy fully the needs of so broad-based a group of users, interested people outside of the profession are nevertheless joining the drive for more comparability in the statements. Criticism in numerous cases is ill-founded for the reader refuses to note the explanations of differences clearly cited in the body of the report or in the notes to the statements. That the auditor's involvement extends only to representing the statements as being fairly presented is not understood by even some of the informed members of the financial community. The expressed or implied indictments by those outside of the profession as to improper reporting of financial information coupled with recent lawsuits against auditors carry overtones of lack of true independence, integrity, and competence. These serious charges, which create considerable journalistic interest, must be met with dedicated effort to examine the growing responsibilities and hazards of the accounting profession in an age of complex international business.

Much of the pressure for improving the communication qualities of the financial statements has been generated within the profession. The specialized meaning of words used in accounting has always presented a problem. In this regard an important contribution has been made by the issuance of the Accounting Terminology Bulletins by the American Institute of Certified Public Accountants. A review of the 1965 edition of Accounting Trends and Techniques[1] revealed increased usage of the suggested terminology, but in some areas conformity has been slow. For example, of the 600 survey companies studied in the compilation of material for the 1965 edition, 122 companies continued to use the designation, "earned surplus," though the case for discontinuance has indeed been strong.

Another step forward in the achievement of improved comparability of financial statements was taken by the action of the Council of the American Institute of Certified Public Accountants which set forth the requirement that, on all financial statements for periods beginning after December 31, 1965, members of the Institute must disclose, either in the notes to the financial statements or in the accompanying auditor's report, any material deviations between the accounting principles used in the financial statements on which they report and those accepted by the Accounting Principles Board. Where practicable, the effect of the departure, as well as the fact of the departure, should be disclosed.

By recommending that listed companies follow opinions of the Accounting Principles Board, the stock exchanges have helped in the drive for improvement in reporting and have influenced industry associations and other organizations to closer and increased collaboration with members of the accounting profession.

Certain provisions of the Internal Revenue Code, in particular those that permit postponement of the recognition of income for tax purposes and increased deductions under accelerated depreciation methods, have had considerable influence on manage-

[1]"Accounting Trends and Techniques in Published Annual Reports—1965," American Institute of Certified Public Accountants, 1966.

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STATEMENT OF OWNERSHIP, MANAGEMENT AND CIRCULATION (Act of October 23, 1962; Section 4369, Title 39, United States Code)

1. Date of filing: October 27, 1966

2. Title of publication: THE WOMAN CPA

3. Frequency of issue: Bi-monthly

4. Location of known office of publication: 327 South LaSalle Street, Chicago, Illinois 60604 (Cook County)

5. Location of the headquarters or general business offices of the publishers: 327 South LaSalle Street, Chicago, Illinois 60604.

6. Names and addresses of publisher, editor, and managing editor:

Publisher, American Woman's Society of Certified Public Accountants; American Society of Women Accountants, 327 South LaSalle Street, Chicago, Illinois 60604.

Editor, Mary J. McCann, CPA, 1700 Power & Light Building, Kansas City, Missouri 64105.

Managing editor, Beatrice C. Langley, 327 South LaSalle Street, Chicago, Illinois 60604.

7. Owner (if owned by a corporation, its name and address must be stated and also immediately thereunder the names and addresses of stockholders owning or holding 1 percent or more of total amount of stock. If not owned by a corporation, the names and addresses of the individual owners must be given. If owned by a partnership or other unincorporated firm, its name and address, as well as that of each individual, must be given.)

Name, American Woman's Society of Certified Public Accountants, 327 South LaSalle Street, Chicago, Illinois 60604; American Society of Women Accountants, 327 South LaSalle Street, Chicago, Illinois 60604.

8. Known bondholders, mortgagees, and other security holders owning or holding 1 percent or more of total amount of bonds, mortgages or other securities (If there are none, so state): None.

9. Paragraphs 7 and 8 include, in cases where the stockholder or security holder appears upon the books of the company as trustee or in any other fiduciary relation, the name of the person or corporation for whom such trustee is acting, also the statements in the two paragraphs show the affiant's full knowledge and belief as to the circumstances and conditions under which stockholders and security holders who do not appear upon the books of the company as trustees, hold stock and securities in a capacity other than that of a bona fide owner. Names and addresses of individuals who are stockholders of a corporation which itself is a stockholder or holder of bonds, mortgages or other securities of the publishing corporation have been included in paragraphs 7 and 8 when the interests of such individuals are equivalent to 1 percent or more of the total amount of the stock or securities of the publishing corporation.

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A. Total No. copies printed (net press run). Average No. copies each issue during preceding 12 months: 6,441. Single issue nearest to filing date: 6,780.

B. Paid circulation.
   1. Sales through dealers and carriers, street vendors and counter sales. Average No. copies each issue during preceding 12 months: None. Single issue nearest to filing date: None.
   2. Mail subscriptions. Average No. copies each issue during preceding 12 months: 5,174. Single issue nearest to filing date: 5,253.

C. Total paid circulation. Average No. copies each issue during preceding 12 months: 5,174. Single issue nearest to filing date: 5,253.

D. Free distribution (including samples) by mail, carrier, or other means. Average No. copies each issue during preceding 12 months: 915. Single issue nearest to filing date: 930.

E. Total distribution (Sum of lines C and D). Average No. copies each issue during preceding 12 months: 6,089. Single issue nearest to filing date: 6,183.

F. Office use, left-over, unaccounted, spoiled after printing. Average No. copies each issue during preceding 12 months: 352. Single issue nearest to filing date: 597.

G. Total (sum of E and F—should equal net press run shown in A). Average No. of copies each issue during preceding 12 months: 6,441. Single issue nearest to filing date: 6,780.

I certify that the statements made by me above are correct and complete.

Beatrice C. Langley
Business Manager

Financial Statements For The Transnational Enterprise

Anita I. Tyra, CPA

The Transnational Enterprise

Since the end of World War II United States corporations have, at an increasing rate, moved some of their operations into other countries. At the present time many of them hold 51% or more of the stock of companies abroad. As the economies of other nations approach a state of maturity, it may be expected that corporations of these countries will follow the pattern established by United States business and seek to expand their operations into world markets to the best of their ability. There are already numerous firms chartered in various European countries which have extensive holdings outside of their national borders. In the future there will be an increased number of companies which have stockholders in many countries, which are manned and managed by persons of many nationalities, which are operated all over the world, which have diversified products and fields of interest, and whose managers are trained to look at the world as an economic unit. Such a company has been termed a transnational enterprise.[1]

The Difficulty of Finding Common Denominators

There are, of course, numerous difficulties involved in the formation and operation of transnational enterprises, one of which is the problem of expressing its financial condition and the results of operations in such a way as to make them easily understood by stockholders of many different nations. There are differences as to the language because the books of the transnational enterprise will normally be kept in the language of the country where its particular local operations are situated. There are differences as to monetary units since a sale made in Holland would be recorded in guilders and one made in India, in rupees.

[1] Donald P. Kirchner, "Now the Transnational Enterprise," Harvard Business Review, March-April 1964, pp. 6-8, 10, 172, 174, 176.

The two differences mentioned above, as to language and currency unit, are immediately apparent because they appear on the face of every financial report. Not as easily visible are the concepts which underlie the words and figures. For instance, the term "Retained Earnings" can be translated into any language. But what does the translated term mean to a German shareholder when there is no retained earnings concept in German accounting?

Likewise, currencies of one country may be translated, through the vehicle of the foreign exchange rate, into money units of another country. Technically, this presents no problem. However, questions arise as to the validity of the translation for numerous reasons, such as, for instance, possible differences between the official exchange rate and a so-called black market rate which may be much more closely related to the real worth of a currency than the official rate. Even if the official exchange rate has been established on the basis of supply and demand and thus represents a fair exchange rate, the results of translation may appear distorted. For example, there may be vast differences in the wage level of different countries. The balance in an account such as Direct Labor when translated from, say, yen into dollars does not truly reflect the utility added to raw materials when viewed by an American shareholder. The intrinsic value of any monetary unit is seldom apparent after translation since the monetary unit is only a symbol for economic goods and utility which loses its identity when the symbol takes on a different meaning to another person.

The solution to this problem would be the creation of a symbol which has the same significance to citizens of all countries. Since existing currencies carry certain implications in the eye of the beholder, the use of a new currency which may be purely fictional would be beneficial. Such a currency would facilitate a fresh approach to understanding valuations on the financial statements of international companies. More will be said about this later.

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The Traditional Use of Exchange Rates

Assets and liabilities stated in foreign currencies which are to be translated normally came into being over a number of years. Consequently, in times of rising prices all over the world, the older balance sheet items are often greatly understated. In addition, the exchange rates themselves may have changed over a period of time.

Traditionally, accountants have tried to restate foreign assets and liabilities in United States dollars of current value by using exchange rates of different dates. Some authorities propose the use of the rate of exchange prevailing on the date of the balance sheet for current assets, and for fixed assets the rate prevailing at the time of acquisition.[2] Others hold that the distinction between current and fixed assets is unrealistic and that monetary assets and liabilities should be translated at the current rate, and non-monetary balance sheet items at their historical rates.[3]

The exchange rate, however, is not designed for and is not effective for converting foreign items of mixed values into one meaningful dollar figure. Such a conversion can only be accomplished through an adjustment of the foreign items for price-level changes. The subject will be discussed further under that topic.

The Problem Regarding Accounting Principles

As stated above, the transnational enterprise is one which is operated and owned internationally. Suppose, for the purpose of illustration, that twenty per cent of its operations are located in the United States, thirty per cent in France, thirty per cent in Germany and twenty per cent in Liberia. Forty per cent of the stockholders live in the United States, forty per cent in France and twenty per cent in Germany. Accounting principles are markedly different in certain respects in these countries. How can meaningful financial reports be prepared under these circumstances? Should four statements be prepared for each operation on the basis of local accounting principles and sent to all stockholders? Or should these four financial statements be consolidated regardless of underlying accounting principles? If one set of accounting principles is applied to the financial statement as a whole, whose principles should be used?

There has been more accounting research in the United States than in any other country. Whether its generally accepted principles and practices are better than those designed abroad is another matter. There are those who will argue the point. Foreign accountants often take exception to such things as the use of the LIFO inventory method, treatment of stock dividends, and a too rigid adherence to the historical cost principle.[4]

Regardless of the individual merits of each country's concept of generally accepted accounting principles, it is not likely that these would be easily adopted by another country. In the past, accounting principles have crossed international borders when they were following large amounts of investments and when the country receiving the investments had no organized body of accounting principles. This situation does not normally prevail in the case of the transnational enterprise and the selection of appropriate accounting principles presents an important problem

The development of "internationally accepted accounting principles" would constitute the ideal solution. That the formation of such principles is not currently within the realm of possibilities is a fact that is brought out by the sluggish or non-existent reaction on the part of the accounting profession to proposals made by Kraayenhof and Mueller regarding an exchange of research findings and the development of greater uniformity in the field of accounting principles.[5]

In the absence of the probability of an early adoption of internationally accepted accounting principles, an attempt should be made to reach an agreement between accounting bodies of different countries regarding accounting standards. Perhaps this would be easier to do for form than for substance of annual reports. In any case, any steps taken in this direction would at least get things under way and would lead, hopefully, to more international uniformity in accounting.

Which Currency Should Be Used?

Presently, when financial statements prepared in different countries are consolidated, various practices are being followed

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[2] American Institute of Certified Public Accountants, Accounting Research Bulletin No. 43, Chapter 12.

[3] Samuel R. Hepworth, "Reporting Foreign Operations," Michigan Business Studies, Volume XII, Number 5, Ann Arbor, University of Michigan, 1956.

[4] For more comprehensive treatment, see Theodore L. Wilkinson, "U.S. Accounting As Viewed From Other Countries," Price Waterhouse Review, Summer 1964.

[5] Jacob Kraayenhof, "International Challenges for Accounting," Journal of Accountancy, January 1960, pp. 34-38 and Gerhard G. Mueller, "Some Thoughts about the International Congress of Accountants," The Accounting Review, October, 1961, pp. 548-554.

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Everybody Talks About It

Wilhelmina H. Zukowska, CPA

Not the weather, in this instance, but the need for improved financial reporting. This was emphasized by both outgoing President Thomas D. Flynn and incoming President Robert M. Trueblood at the 78th annual meeting of the American Institute of Certified Public Accountants in Dallas, September 19-22, 1965.[1] The same theme was stressed in the papers presented at the Hayden, Stone and Company, Inc., Fourth Annual Accounting Forum, New York University Graduate School, on November 18, 1965.[2] In 1965, delegates from fifteen Asian-Pacific countries meeting at New Delhi, India, at the Fourth Asian-Pacific Accounting Conference discussed "the need for developing international terminology and uniform accounting practices."[3]

Everybody talks about the need for improved financial reporting, but is anybody doing anything about it?

A prominent member of the accounting profession stated that "a great many people are giving a lot of attention these days to improvements in corporate financial reporting in a number of directions."[4] Evidence of this can be found throughout the accounting literature, but it is proposed herein that the primary direction of this attention should be in the development of a precise terminology, the lack of which was an important weakness in the development of accounting principles during the 1930's and 1940's.[5] At that time "there was a tendency (which unfortunately has persisted) for each writer or group to use terms as he saw fit; sometimes the usage was explained, and sometimes it was taken for granted that it would be understood."[6] In the matter of terminology, "accountants have been extremely careless . . . and the situation has degenerated to such a state that it is doubtful whether accountants really understand each other. The formulation of a set of precise terms is prerequisite to development in any field of endeavor."[7]

A president of the American Institute of Certified Public Accountants said "that many of the tasks facing the profession come down to a matter of communication."[8] This was evident in some of the criticism directed against Accounting Research Study No. 3.[9] Several of the proposed principles "which have been manifested in financial statements for years and presumably, therefore, are generally accepted"[10] had been identified as "radical departures" from practice.

Throughout the accounting literature, examples can be found wherein accounting principles are equated with accounting procedures. But "principles" and "procedures" are not synonyms. This confusion is at the core of the many animated controversies generated since the implementation of the AICPA's new research program in 1959. A current article points out that:

> One of the more serious omissions of all statements on accounting principles is adequate preliminary discussion of the manner in which "principles" is to be interpreted. There is a tendency to suppose that we can get along quite well without exercises in definition. In no other field having any pretension to rigor of thought or development is this presumption entertained.[11]

It is sometimes pointed out that in the area of auditing this confusion does not exist, or has not existed. There is a statement of generally accepted auditing standards, and there are Statements on Auditing Procedures and Case Studies in Auditing Procedures on particular matters. A very important distinction has been made between auditing standards (which do not change) and auditing procedures (which must adapt to the environment).

This distinction was carefully guarded until 1963 when the Committee on Auditing Procedure of the AICPA issued Statements on Auditing Procedure No. 33, entitled *Auditing Standards and Procedures.* Now this dis-

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[1] "News Report," The Journal of Accountancy, Volume 120, November 1965, p. 12.

[2] "Statements in Quotes," The Journal of Accountancy, Volume 121, February 1966, pp. 47-55.

[3] "News Report," The Journal of Accountancy, Volume 121, March 1966, p. 18.

[4] Herman W. Bevis, "Earnings per Share and the Need for Full Disclosure," The Journal of Accountancy, Volume 121, February 1966, p. 52.

[5] Reed K. Storey, *The Search for Accounting Principles,* The American Institute of Certified Public Accountants, Inc., 1964, p. 61.

[6] *Ibid.,* p. 21.

[7] *Ibid.,* p. 62.

[8] Robert M. Trueblood, "A Forward-Looking Forum," The CPA, Volume 45, December 1965, p. 2.

[9] Robert T. Sprouse and Maurice Moonitz, *A Tentative Set of Broad Accounting Principles for Business Enterprises* (New York: AICPA, 1962).

[10] Robert T. Sprouse, "The 'Radically Different' Principles of Accounting Research Study No. 3," The Journal of Accountancy, Volume 117, May 1964, p. 64.

[11] R. J. Chambers, "A Matter of Principle," The Accounting Review, Volume XLI, July 1966, p. 447.

tinction has become blurred and we are venturing out on troubled waters if we do not heed a former chairman of the Institute's auditing procedure committee. He said:

> It is highly important to the profession and to the public that the aberrations in the distinctions between generally accepted auditing standards and auditing procedures be corrected as soon as possible. I believe it was a mistake to merge generally accepted auditing standards in a codification of the committee's Statements on Auditing Procedure. If such a merger was to be made, considerably greater care should have been taken to preserve the distinctions than is evident in the present structure of SAP No. 33.[12]

In an attempt to promote uniformity in the usage of accounting terms, the 1952-1953 Committee on Terminology of the AICPA stated that "events have forced accountants to give more careful consideration to the use of words, as the responsibilities that may flow from careless or inaccurate usage have become more serious and manifest."[13] The Committee made specific recommendations as to word usage and in AICPA's yearly publication of *Accounting Trends and Techniques*, reporting practices of 600 corporations are compared to the Accounting Terminology Bulletins.

Rugged individualism and ingrained habits notwithstanding, some of the recommendations have influenced reporting practices. The troublesome word "reserve" is used less frequently to describe uncollectible accounts, giving way to "allowance" in the majority of the reports analyzed.[14] In the area of Property, Plant and Equipment, the term "reserve" is being used infrequently; "accumulated depreciation" is the preferred terminology.[15] As a "liability reserve," the term was used by only 6% of the companies included in the survey in connection with an Income Tax Liability; over 75% of the companies indicated a preference for the terms "estimated" or "accrued."[16]

Another troublesome word, "surplus," was considered by the Committee on Terminology. "In 1949, this committee secured the approval of the committee on accounting procedure for its recommendation that the use of the term "surplus" in balance-sheet presentations be discontinued."[17] As a result, a survey of the reporting practices of 600 corporations revealed that 54% of the companies had replaced the term "surplus" with more descriptive terminology.[18]

At this point, however, some inconsistencies appear. Section 4 of *Accounting Trends and Techniques* is entitled "Retained Earnings and Capital Surplus" but contains the following paragraph:

> The term *capital surplus* is used in this section to classify all surplus accounts exclusive of retained earnings. Although the committee on terminology of the American Institute of Certified Public Accountants has recommended a general discontinuance of the use of the term *surplus* in corporate accounting and this objective has been approved by the committee on accounting procedure, the term *capital surplus* is used here as a technical term to indicate the nature of the accounts discussed.[19]

In the advertisement[20] prepared for the promotion of *Accounting Trends and Techniques*, "capital surplus" is distinctly listed. The implication seems to be that there is no objection to the term "surplus" in describing a section of the balance sheet. In this way, and because *Accounting Trends and Techniques* is used as a reference source by many accountants, the use of the term "surplus" is being perpetuated; the arguments against its use as part of Stockholders' Equity are being nullified.

In *Professional Accounting in 25 Countries* published by the AICPA in 1964, there are many references to "surplus" in the chapter describing accounting in the United States of America. In the Illustrative Balance Sheet, Exhibit 1(a), under the heading "Capital," the term "surplus" appears with "Earned Surplus" as a sub-heading. Exhibit 1(b) is entitled "Illustrative Statement of Income and Earned Surplus of a United States Company." Presumably, these model statements will be of interest to both national and international accountants. Have not the efforts of the Committee on Terminology been negated with this example?

In defining accounting, the Committee on Terminology stated that it was the

> . . . art of recording, classifying, and

[12] Paul Grady, "The Independent Auditing and Reporting Function of the CPA," The Journal of Accountancy, Volume 120, November 1965, p. 66.

[13] Committee on Terminology, "Accounting Terminology Bulletins, Number 1, Review and Resume," p. 7, *Accounting Research and Terminology Bulletins, Final Edition, 1961*, New York, AICPA.

[14] Staff of the AICPA, *Accounting Trends and Techniques—1964 Eighteenth Edition*, AICPA, 1964, pp. 36-37.

[15] *Ibid.*, pp. 60-61.

[16] *Ibid.*, pp. 85-86.

[17] Committee on Terminology, *op. cit.*, p. 15.

[18] Staff of the AICPA, *op. cit.*, pp. 10-11.

[19] *Ibid.*, p. 211.

[20] The Journal of Accountancy, Volume 120, November 1965, p. 90.

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IN MEMORY OF IDA S. BROO

WHEREAS, the American Society of Women Accountants desires to record its deep sorrow at the death on September 12, 1966, of its beloved founder, Ida S. Broo, of Indianapolis Chapter Number One, who served this Society as its first president and has been a guiding influence in succeeding years,

NOW, THEREFORE, BE IT RESOLVED that the members of this Society give formal expression of their grievous loss in the passing from life of a woman whose foresight, vision, and wisdom was so instrumental in the formulation of this Society, whose dedication to the Society never dimmed, a woman who was esteemed by her associates, loved by her friends, and respected by all members of this Society.

BE IT RESOLVED FURTHER that a copy of this Resolution over the signature of the National President and National Secretary, and under the seal of this Society be tendered to her family and her chapter, Indianapolis Chapter Number One, American Society of Women Accountants, as a humble expression of the Society's heartfelt sympathy in their bereavement.

BE IT FURTHER RESOLVED that this Resolution be spread upon the minutes of the Annual Business Meeting of September 30, 1966, and that it be published in *The Woman CPA* and the *ASWA Coordinator.*

In a memorial resolution presented at its annual business meeting on October 1, 1966, The American Woman's Society of Certified Public Accountants expressed its deep sorrow and inestimable loss in the death of its beloved member, Ida S. Broo, who served as the fifth president of the Society and who expanded its horizons in the founding of the American Society of Women Accountants.

Trends of Special Interest to the Accountant in Financial Reports

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ment's choice of accounting methods, irrespective of the ever-present underlying concern for showing current favorable performance on the financial statements. Accordingly, the problem of comparability has become more involved.

Because a detailed account-by-account comparison has been readily possible in judging the performance of government-regulated companies for which a uniform system of accounts has been prescribed, the financial statements of these companies have been pointed out as fulfilling the requirement of uniformity in financial reporting. If so, have sound, uniform accounting principles been applied to the items going into each account? Still a closer look at the facts reveals that regulated companies must comply with accounting requirements promulgated by various authorities and thus must be able to furnish different sets of figures. In the case of one reporting company, the overlapping jurisdictions were Federal and state commissions, and in an opinion footnote, the auditors stated their belief that since the state had the major jurisdiction over the affairs of the company, the statements based on the state's accounting requirements were most useful to the company's stockholders.

Has the Securities and Exchange Commission been involved in the movement toward uniformity in financial reporting? The Securities Exchange Act of 1934 made mandatory the filing of annual reports of listed companies, and these reports were made available to the public. In May 1964, the Commission with its broad authority over prospectuses and annual reports set forth a new requirement that the reports to stockholders be based on accounting practices and principles generally consistent with those required for financial statements filed with the Commission and that any material deviations therefrom be noted in the stockholder reports and any resultant differences reconciled with the Commission report. In answer to a "formal petition" by a public accounting firm, the Commission issued on December 7, 1965 Accounting Series Release No. 102 which requires that, effective for fiscal years ending on or after December 31, 1965, deferred income taxes arising out of installment sales be classified as a current liability if the related installment receivables are classified as current assets and consequently ruled out the practices of show-

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Trends of Special Interest to the Accountant in Financial Reports

(Continued from page 9)

ing the deferred income tax account as a noncurrent liability and the related installment receivables as a current asset.

With the growing emphasis on "cash flow," a term exceedingly popular with security analysts, the statement of source and application of funds has been added as supplementary information in financial reports. Accountants have expressed concern about financial articles that foster the erroneous impression that the "cash flow" figure is to be considered superior and as a substitute for the net income properly determined as a measure of the company's real earning power. The New York Stock Exchange early in 1964 in a letter addressed to presidents of companies listed on the Big Board urged that a statement of source and application of funds be included in future annual reports to stockholders. In Interpretive Opinion No. 3, The Statement of Source and Application of Funds, the Accounting Principles Board of AICPA stated the opinion that "inclusion of such information is not mandatory and it is optional as to whether it should be covered in the report of the independent accountant." Of the 600 survey companies reviewed in the 1965 edition of Accounting Trends and Techniques, 191 companies included funds statements in their annual reports, and the auditors referred to the funds statements in the following areas of the reports: five in the scope paragraph, eighty-two in the opinion paragraph, eighty-six in the scope and the opinion paragraphs, and eighteen in a separate place in the report.

What are the current problems to which accountants are directing their study and effort in the endeavor to provide more meaningful financial information?

Published interim reports become more popular each day and are fast becoming an integral part of the financial communication programs of numerous corporations. Security analysts and stockholders, continuing the drive for putting the investor on notice, want important financial developments reported more often than annually at the end of the fiscal period. They complain that unusually significant events, known almost immediately to insiders, are revealed only in the reports which are distributed sometimes long after the close of the fiscal year. Some of the stock exchanges are requiring the publication of interim earnings statements. Although accountants note that brief reports may be misleading, that the user may erroneously apply a multiple factor to forecast annual results, and that the reports of corporate-management activities may be overly enthusiastic, the interim report is here to stay and is within the province of the public accountant. Some are suggesting that the audit program include a review of the interim reports issued since the last published annual report, and that the auditor furnish a statement to the effect that the format and contents have been examined and that any abnormalities have been explained in the accompanying footnotes.

The statement, "prices go up and prices go down," seems to have lost some popularity in the last few years. Whenever prices are changing noticeably and in one direction, particularly over an extended period of time, considerable stimulation is given to the measurement problems involved in financial reporting. Do business entities have an accountability for reporting changes in capital resources and the results of operations in terms of price-level changes? At this time, opinions differ.

The advocates of historical cost point to the high degree of verifiability, the lack of personal bias, alleged limitations of price-index numbers, complex adjustment procedures not readily understandable, adequate parenthetical and footnote presentations showing current information, and the possible ultimate abandonment of historical statements. Others believe that certain accounts, such as inventories and fixed assets, should be shown at current costs in the financial statements and that a reconciliation with the conventional-form statement should be set forth in a footnote. Still others define "price-level adjustments" as meaning replacement cost as used in appraisals and would adjust each account accordingly, giving no consideration to overvaluation problems.

A substantial part of the criticism of statements based on historical cost concerns the comparability of these statements. Recent studies, however, point toward some agreement in accounting circles as to the recognition of price-level changes.

The Staff of the Accounting Research Division of the American Institute of Certified Public Accountants in Accounting Research Study No. 6, "Reporting the Financial Effects of Price-Level Changes," recommends that all items on both the balance sheet and the income statement be restated by means of a single index of the general price level and that a net gain or loss on monetary items be shown as a separate item in the statements. The adjusted figures are to be shown as supplemental statements or in extra columns in the primary financial exhibits.

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TAX FORUM

DORIS L. BOSWORTH, CPA, Editor

YEAR-END TAX PLANNING

All things being equal, the rumored increase in individual and corporate tax rates in 1967 should play an important part in year-end tax planning. Admittedly, the shifting of income and deductions may fall short of the goal in the absence of knowledge as to the actual new rates, but present thinking tends toward the belief that the change will not be too drastic. Under these circumstances the present tax bracket of the taxpayer should be carefully studied. If in 1966 an individual is at the lower level of a particular tax bracket, it may pay to accelerate income or defer deductions to the extent of the range in that bracket, as all of the income will be taxed at the same rate. If the reverse is true, however, it would be foolhardy to increase current year's income, putting the taxpayer in a higher bracket. Of course, if a tremendous increase in income is anticipated, relief will be afforded under the income-averaging provisions of the Code.

We are all acquainted with the basic principles involved in shifting of income and deductions, and the relative simplicity of shifting income for cash basis taxpayers, as compared to those employing the accrual method. For that reason, only in a few areas, where a new element has entered the picture, will tax planning be discussed.

Contributions:

One way of reducing income, if that is the indicated move, is to make charitable contributions to the fullest extent allowable. The caveat here is, of course, Section 170(e) of the Internal Revenue Code which requires the reduction in the fair market value of a gift of property to the extent of recapture of depreciation under Sections 1245 and 1250. This means that if you transfer property which has appreciated greatly in value, the benefits of this appreciation may be lost when that value is reduced by the amount of depreciation taken after December 31, 1961 in the case of Section 1245 property, and after December 31, 1963 for Section 1250 property. Similarly, early disposition of property to a charity may result in the recapture of the investment credit under Section 47 of the Internal Revenue Code.

The five-year carryover rule as applied to individuals should, in most instances, prove helpful. A large gift of property can be made in 1966 to an institution of the so-called 30% type, and the excess over the current year's limitation may be carried over and utilized in five successive tax years. This will serve to level off income in those years, in that any increase in adjusted gross income will carry with it an increase in the contribution deduction. Caution must be exercised in determining those charities which meet the 30% requirement of receiving a substantial amount of their support from the general public (*Tax Forum*, October 1966 issue, THE WOMAN CPA).

Year-End Distributions:

Once earnings have accumulated to the $100,000 mark, every corporation that is closely held must give consideration to dividend distributions that will eliminate the possibility of a tax on undistributed earnings under Section 531 of the Internal Revenue Code. On the other hand, the shareholders, if already in high brackets, tend to resist receiving additional income. The conflict of interests looms large at year-end; and if retention of profits by the corporation is to be justified, the reasonable needs of the business must be established. In a year in which it is deemed expedient to forego distributions, the business purpose must be carefully documented in the minutes and subsequently reinforced by definitive action by the corporation to utilize the funds retained. Where no substantial business purpose could justify retention of earnings in the past, it was felt that a liberal dividend policy would circumvent Section 531. This reasoning was recently upset in *Henry Van Hummell, Inc. v. Commissioner, U.S.C.A. (10th Circuit) No. 8104* where the taxpayer had paid out over a thirty-year period an average of approximately 60% of its net income after taxes. Although the Court commented upon the liberality of dividend payment history, nevertheless it ruled in favor of the Tax Court because of lack of business purpose to justify the retention of any net earnings. If that situation obtains, it may be well to declare and pay a dividend prior to the close of the current year in order to bring the shareholder's income into the year of a lower tax rate. The corporation will get credit for the current year's payment, and any payment within two and one-half months after the close of the year, in determining vulnerability to Section 531. The shareholder will be able to average income to his advantage in the two years.

An alternative solution to the problem of a corporation that is faced with the dilemma of a Section 531 problem is the election of Subchapter S status within the first thirty days of the 1967 year. Here, however, the shareholders are compelled to pick up in their individual returns the entire net income of the corporation whether or not distributed. The election negates the possibility of retention of possible future profits, should it be justified.

D.L.B.

Trends of Special Interest to the Accountant in Financial Reports

(Continued from page 10)

In the booklet recently published by the American Accounting Association, "A Statement of Basic Accounting Theory," it is suggested that both historical cost and current cost be presented in adjacent columns and that current cost be secured by reference to established market price or through application of a price index to acquisition cost.

With the stress on the usefulness of financial reports comes the realization that there is a decided trend toward getting away from using technical terms that do not have precise meaning. Though there is a natural desire to reduce to a minimum the number of words used, there has been increasing growth in the footnote area and in the number of statements that show the explanations of the items directly below each title. Improvements in format, content, and other facets of the published annual report are part of management's continuous effort to maximize communication with stockholders.

In some minds, the earnings-per-share statistic is the figure that is accepted as summarizing all activity. Investment decisions are made accordingly with no consideration given to the possibility that a portion of the earnings-per-share amount may be due to income from unusual transactions and with a complete disregard of all other pertinent data. Thus, as another step in improved reporting, it is suggested that where applicable in the presentation of the earnings-per-share figure, the portion of this figure contributed by net income from operations and the remainder derived from income due to unusual transactions be separately stated. More detailed information will be forthcoming if the SEC concludes, as the result of a current study, that sales and profits for specific lines and services should be shown in detail. Concurrently, some writers of financial articles are stressing the need for presentation of individual company statements as well as the consolidated statement in cases where the individual statements are more meaningful.

The comparative financial statements that are a popular presentation in today's financial report may someday be replaced by financial statements showing a ten-year span with explanatory commentary by management as to the cause and significance of fluctuations. Increasing international business and investments augment the possibility that the present problems of uniformity and comparability in financial reports will be shifted from the local and national scene to an international setting. The present views in disputed accounting areas are surprisingly divergent, but they pose as a necessary forerunner to more profound research into what is needed. Accountants may differ as to the proper course of action, but there is evident an underlying general agreement that there will be expansion of the accounting discipline to give more information and to move ultimately toward international uniformity of accounting and auditing standards.

Financial Statements for the Transnational Enterprise

(Continued from page 6)

as to currency shown. Where United States corporations hold 51% or more of the stock of a foreign subsidiary, the United States dollar is used in the statements. Companies of two foreign countries consolidating their financial statements frequently use a fictional monetary unit, such as the Eurodollar which is based on the gold standard. Finally, there are corporations whose management believes that a translation of one currency into another is not meaningful.

A Fictional Currency

As brought out above, the transnational enterprise must arrive at some common denominator in the preparation of its financial reports. Since in all likelihood a number of different currencies are involved, it seems logical that the use of a fictional currency might be of great help.

There are several advantages to employing a fictional monetary unit. The use of any one country's currency might meet considerable resistance because it would seem to give this country a special position of importance or superiority over other nationalities' interests in the enterprise. A fictional currency cannot be opposed on the basis of nationalistic feelings. Secondly, a fictional, imaginary monetary unit is not subject to fluctuating exchange rates set by national governments. If its value were related

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TIPS FOR BUSY READERS

MARY F. HALL, CPA, Editor

Journal Of Accounting Research, Published jointly by University of Chicago and University of London, semi-annually.

This publication is a relative newcomer to the list of periodicals in the accounting area. It is published semi-annually (spring and fall) through the joint efforts of the Institute of Professional Accounting, Graduate School of Business, University of Chicago, and the London School of Economics and Political Science, University of London. The first issue was published in the spring of 1963. The subscription rate is $4.50 per year with an additional charge of $4 for each additional year ordered.

Each issue contains four to seven articles with the authorship divided between Englishmen and Americans. Three special sections are included in each issue, Research Reports, The Reviewer's Corner, and Capsules and Comments. The research reports tend to be primarily quantitative studies and accordingly contain charts, graphs, mathematical formulas, probabilities, and linear programming. The Reviewer's Corner ordinarily contains reviews of one or more books. Sometimes, however, there appear short retorts provoked by research studies or articles which appeared in previous issues of the magazine. Capsules and Comments tend to be brief contributions of almost any description. This section is omitted in issues which contain more numerous feature articles.

Recent issues have contained articles on Accounting Research Study No. 6 prepared and published by the American Institute of Certified Public Accountants. Several articles from the *Journal* have been reviewed in past issues of *The Woman CPA.* Since this is a journal of accounting research, many of the articles are more theoretical than those published in *The Accounting Review* or *The Journal of Accountancy.*

Altogether the *Journal* is one which, if read, will stretch the horizons of the accountant and be a tool for self-development and continuing education.

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"An Accounts Payable Application of EDP," John R. Nichols, *National Association of Accountants Management Accounting,* March 1966, Volume XLVII, Number 7.

This case study deals with the various processes used in converting an accounts payable system from a manual operation to electronic data processing equipment, but it is pointed out that most of the aspects described in this case study are also applicable to, conversion of other accounting procedures. Electronic data processing equipment is defined as a computing machine which operates on information or data by means of an internally stored program and which has multiple input-output units.

As I read the article, I was impressed with the planning which had been done by the company and the outside consultants making this conversion. The objectives of the new accounts payable application are stated; the steps in the procedure used in converting to the computer are listed; and the old system and its requirements are discussed; and this is followed by a discussion of the new requirements. Also included are six illustrations of forms and information used in the accounts payable department, and five flow charts of the accounts payable EDP procedure.

A new accounts payable system was designed and then the programming effort began. The article lists the information given to the programmer and also the requirements regarding documentation which the programmer was to fulfill. After the programs were prepared, the company checked them out by a period of parallel or dual operation. The actual time spent in each phase of the conversion to the new accounts payable system was two weeks for fact finding, six weeks for system requirements design, five weeks for programming and three weeks for the parallel operation, a total of sixteen weeks. The author states that there were some savings in miscellaneous equipment and clerical staff, but the company's operating and equipment costs were actually higher after the installation of electronic data processing equipment. The great benefit to the company, however, was not in cost saving, but in the effective use of information which was not available under the previous system.

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Financial Statements for the Transnational Enterprise

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to the price of gold, it would have additional stability. Thirdly, an imaginary unit may be used by all transnational enterprises regardless of the location of their operations and shareholders, and would therefore contribute to the comparability of their respective financial statements.

Adjusting for Price Level Changes

The accounting profession in the United States has been concerned about inflation for a long time. Various studies have been made on accounting for price-level changes but have brought about no changes in accounting principles in the United States.

Accountants abroad have been much more progressive, perhaps mainly because the faster rate of inflation in their countries forced them to adjust accounting concepts. In most instances, accountants of other countries expressed historical costs at the new values of their respective currencies. The Dutch went one step beyond this and are using replacement costs in revaluing assets.

As far as finding a basis for a valuation of the assets and liabilities of transnational enterprises is concerned, neither unadjusted historical cost nor replacement value seems suitable. Domestic financial statements based on historical cost reflect a mixture of currency units of different value, and such a mixture does not normally result in meaningful figures. The use of unadjusted historical cost in reports of the transnational enterprise is even more unrealistic because a great many currencies may be involved, some of which have experienced drastic changes in value. The replacement value method, while it seems to work very well in The Netherlands, has not found acceptance anywhere else.

One method that satisfies the need for an adjustment of the accounts to changes in the purchasing power of money and yet does not stray too far from accounting conventions is the valuation of assets and liabilities based on historical cost adjusted for price-level changes. This method has the advantage of majority approval since it is now in use in most countries. Should Accounting Research Study No. 6 be approved by the Accounting Principles Board, United States accountants should have no objections to employing historical cost adjusted for price-level changes in the reports of international enterprises.

The procedure of adjusting for price-level changes is conservative in that it does not abandon cost concepts. It is progressive because it does recognize that currencies expended in different years carry different values and it adjusts them accordingly.

Exchange Rates

After the accounts have been adjusted for changes in the purchasing power of money (needless to say, this would not normally be done in the books of account but only for the purpose of preparing financial statements), it must be determined which exchange rate should be used in order to translate the respective currencies into that fictional unit which is to serve as the common monetary unit in the report of the transnational enterprise. Since all accounts before translation have already been expressed in money of uniform value, the exchange rate no longer has the function of converting monetary units of differing value of one currency into monetary units of uniform value of another currency. Consequently, the selection of the proper exchange rate no longer poses a difficult problem. All items in the financial statements may be translated at the current rate.

The translation of currencies often results in gains or losses, the disposition of which poses additional problems. A discussion of alternative treatment of these translation gains and losses is beyond the scope of this article.

Conclusions

The method of preparing financial statements for the transnational enterprise which has been outlined is fairly simple and straightforward. Such statements satisfy the need for consistency and comparability. They are based on the cost principle which is in effect in a majority of countries. They are relatively free from distortions.

While the underlying accounting records would be kept in accordance with local law and custom in order to comply with the various government regulations in effect, the financial statements would be designed to afford the stockholders of the transnational enterprise a better understanding of the condition and results of operations of the corporation in which they have invested their funds.

Everybody Talks About It

(Continued from page 8)

summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.[21]

[21] Committee on Terminology, *op. cit.*, p. 9.

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EDITOR'S PAGE

All of the feature articles in this issue are concerned with financial reporting, an area of much controversy and criticism and of much study and research. It comes up for frequent consideration because it is so important not only to our profession but also to all the individuals and groups in the business world, in the financial community, in government and in the general public who read and interpret financial reports. We hope that the articles presented will bring you some of the current ideas and thinking and stimulate your interest in this vital matter.

AUTHORS IN THIS ISSUE

One of the technical sessions at the 1966 AWSCPA-ASWA joint annual meeting in Boston consisted of four plenary sessions at which trends of special interest to the accountant were discussed. The first article in this issue, "Trends of Special Interest to the Accountant in Financial Reports," is the manuscript of a talk given at one of the sessions. The author, Katherine M. West, CPA, is assistant professor in The City University of New York (Brooklyn College) and engages in her own public accounting practice. Miss West received her A.B. (cum laude) degree from Hunter College and her M.S. degree from Columbia University. She is a member of both AWSCPA and ASWA and of numerous other professional accounting organizations. She is a past president of the New York Chapter of ASWA.

"Financial Statements for Transnational Enterprises" deals with perplexing problems in international accounting, an area of accounting which is becoming increasingly important. The author, Anita I. Tyra, CPA, teaches accounting at the Bellevue Community College in Bellevue, Washington. Mrs. Tyra is a member of AWSCPA and the Seattle Chapter of ASWA. She holds an M.A. degree in Business Administration from the University of Washington.

The article entitled "Everybody Talks About It" was written in response to the editor's invitation to the members of AWSCPA and ASWA to submit articles for publication. The author, Wilhelmina H. Zukowska, CPA, has written that she feels quite strongly about the problem of terminology and had been trying for some time to find time to put her thoughts down on paper. Miss Zukowska is an assistant professor of accounting at The University of Miami at Coral Gables, Florida. She is a member of AWSCPA and has submitted an application for membership in the Miami Chapter of ASWA. She is also a member of several other professional accounting organizations.

EDITORIAL BOARD CHANGES

Recognition of retiring editorial board members and introduction of new members will appear in the February 1967 issue.

CHANGE OF ADDRESS

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Everybody Talks About It

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The image arises that accounting is . . . recording, classifying, and summarizing—with interpreting (a most significant part of the definition) appearing as an afterthought. The image is not what many think it should be. Often in the accounting literature, accounting has been defined as the measurement and communication of financial and other economic data. In the American Accounting Association's 1966 *Statement of Basic Accounting Theory*, accounting is defined "as the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information."

It is questioned whether the time is not ripe for a serious reexamination of all Accounting Terminology Bulletins. In the meantime, some effort should be made toward achieving a cohesive relationship between the Bulletins and all publications of the American Institute of Certified Public Accountants, including advertisements. The image of the profession which we are projecting to the public is being muddied by our definition of accounting and the inconsistent use of suggested terminology.

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